

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

ORIGINAL
WITH PROOF
OF SERVICE

77-6145

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

BERTHA LEMLE,

Plaintiff-Appellant,

-against-

UNITED STATES OF AMERICA,

Defendant-Appellee.

ON APPEAL FROM A FINAL JUDGMENT OF THE
UNITED STATES DISTRICT COURT FOR THE SOUTHERN
DISTRICT OF NEW YORK

BRIEF OF BERTHA LEMLE AS
PLAINTIFF-APPELLANT

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On Appeal from a Final Judgment of the United
States District Court for the Southern District
of New York

BRIEF OF BERTHA LEMLE AS
PLAINTIFF-APPELLANT

Preliminary Statement

Bertha Lemle ("Mrs. Lemle") appeals from the
judgment of the District Court (Conner, J.), which granted
summary judgment dismissing her complaint.

The action sought an income tax refund of
\$23,994.39, assessed against Mrs. Lemle by the I.R.S. on

certain principal distributions received by Mrs. Lemle from the Estate of Julius Lemle, her deceased husband, in lieu of her statutory one-third share [A-15, A-33, A-44, A-66-7]*.

The Issues Presented

1. Did the District Court err in rejecting Mrs. Lemle's claim that payments made in settlement of her right to elect to take her one-third share of the corpus of the Estate in lieu of her share under the Will were not taxable under Section 102(a)**, which excludes from "gross income . . . property acquired by gift, devise, bequest or inheritance"; and Section 663(a), which excludes from taxable income under Section 662(a) "Any amount which under the terms of the governing instrument, is properly paid as a gift or bequest of a specific sum of money", though the District Court agreed that under Lyeth v. Hoey, 305 U.S. 188 (1938), "money received by an heir in settlement of a will contest is to be treated as if were acquired by inheritance" [A-117]?

* References are to pages of the Joint Appendix.

** All statutory references are to Sections of the Internal Revenue Code.

2. Did the District Court err in determining that the settlement payments were taxable because under I.R.S. Regulation 1.663(a)-1(b)(1), "to qualify as a gift or bequest of a specific sum of money or of specific property under Section 663(a), the amount of money or of specific property must be ascertainable under the terms of a testator's will as of the date of his death"[A-155]?

Statement of the Case

The case has had a bizarre background, involving repeated changes of position, both by the I.R.S. and the District Court.

1. The pre-settlement payments received by Mrs. Lemle were reported in her tax returns for 1965, 1966 and 1967 as non-taxable distributions of principal on account of her claimed elective share [A-85]. Though audit reports of the I.R.S. agent filed in 1967 and 1968 found deficiencies in tax, when Mrs. Lemle paid the tax in 1969 and filed her claim for refund in that year, her claim was allowed in full by the I.R.S. in a report dated June 15, 1971 on the basis of the approval by the Surrogate of the Settlement Agreement [A-105]. This report was overruled years later

because of the happenstance that the other income beneficiaries, who had undertaken to pay the tax as part of the settlement, reneged on their agreement [A-95].

2. When plaintiff moved for summary judgment, Judge Conner accepted her claim to having received a non-taxable inheritance under Lyeth v. Hoey; but in view of a belated argument by the I.R.S. that the Settlement Agreement "might be collusive", deferred final decision pending the presentation of proof on that subject by the I.R.S. [A-111, A-120].

3. When the Government conceded it had no proof of collusion, it asserted a new legal theory "skeletonized" in an affidavit [A-84], which the District Court ultimately accepted in reliance upon an I.R.S. regulation applicable to a testamentary provision, which, as will be shown, is clearly inapplicable.

The Factual Background

Mrs. Lemle's Right of Election

After her husband's will was probated in November, 1965, Mrs. Lemle on February 3, 1966 exercised her right of election against the Will [A-18, A-50]. The executors having rejected her claim on the ground that she had waived

her rights in an anti-nuptial agreement [A-50], Mrs. Lemle filed a Surrogate's Court proceeding seeking an adjudication of the validity of her claim to an elective share, asserting fraud in the execution of the pre-nuptial contract [A-64].

In the years that followed, there was extensive litigation including pre-trial depositions of many of the parties, a motion to dismiss affirmative defenses, and an appeal to the Appellate Division [A-64]. After protracted settlement negotiations, and on the eve of trial, scheduled for August 19, 1970, settlement agreements were entered into dated as of August 12, 1970 [A-60, A-71].

The Settlement Agreements

The principal Settlement Agreement provided for the withdrawal by the executors of "all objections" to Mrs. Lemle's right "to take an elective share" against the Will; and that, in full settlement of her said "elective share", the Estate would pay to her "the sum of \$453,712.25 payable out of the principal" of the Estate [A-66, ¶ 1a].

Payment of this lump sum was to be made as follows:

- a) \$216,974.86 (previously paid);
- b) \$40,437.39 in cash;
- c) \$145,800 by a first mortgage note; and
- d) \$50,500 by assignment of a subordinated mortgage note.

(The cash, note and mortgages were to be delivered within 60 days after the approval of the settlement by the Surrogate.) [A-67]

The Second Agreement

A further agreement was entered into in which it was provided that the Estate would pay to the income beneficiaries "an amount equal to the amount of all income taxes, interest and penalties, if any" which would be payable by them as a result of the consummation of the first Settlement Agreement with Mrs. Lemle [A-74].

To implement this undertaking, it was provided that the firm of "Messrs. Yoholem, Gillman & Stein, CPAs, would prepare whatever amended tax returns may be necessary . . ." [A-75, ¶2]. These payments too were to be "charged to principal" [A-75].

Acquiescence by the I.R.S. in Mrs. Lemle's Receipt of Non-Taxable Distributions of Principal

While the proceedings in the Surrogate's Court were pending, the executors, in the course of the routine administration of the Estate, paid to Mrs. Lemle her one-third share of the income under the Will [A-131].

The payments made were as follows:

1965	\$20,888.54	[A-36]
1966	\$23,930.71	[A-38]
1967	\$19,146.38	[A-41]

Though the payments were labeled "income distributions" by the executors, Mrs. Lemle, through her counsel, disclaimed receipt of these payments as income and in letters to the executors, asserted that the payments were properly due her on account of her elective share of the Estate [A-27]. Thus, on December 7, 1965, Mrs. Lemle's counsel wrote the executors' attorney [A-27]:

"We are both agreed . . . that no inference will be drawn from the issuance and acceptance of the check as to Mrs. Lemle's rights as a surviving spouse."

Plaintiff-s 9-g Statement, expressly admitted by the Government [A-81, A-97], states:

"Plaintiff, through her attorney, by letters dated December 7, 1965 and August 13, 1966 to the attorneys and accountants for the estate, respectively, gave notice that said distributions were being accepted as distributions of principal pursuant to her election and that she waived no claims or rights by accepting them."

The I.R.S. had been similarly advised of Mrs. Lemle's claim to principal. In his affidavit on the summary judgment motion, Mr. Ballaine, Assistant United States

Attorney, states [A-85]:

"In filing her Federal income tax returns for 1965, 1966 and 1967, plaintiff clearly indicated that she had received income distributions from the Estate but that she considered the distributions received to be payments of her share of corpus and thus not taxable under 26 U.S.C. §102(a)."

There is no doubt that the I.R.S. agent, Edward R. Levitus, who had assessed the deficiencies against Mrs. Lemle in 1967 and 1968 audits [A-33, A-37] was aware of the negotiations for the settlement of her claim to an elective share and, in substance, at all times agreed that if the agreement were consummated and approved by the Surrogate, she would be entitled to a refund. Thus, in his affidavit on the summary judgment motion, he referred to Mrs. Lemle's claim that the payments made to her were on account "of her share of the corpus of the estate . . . under a right of election as surviving spouse of Julius Lemle" [A-93]; acknowledged that he discussed these negotiations with Mrs. Lemle's attorney; and that he was advised on April 27, 1971 that "the Surrogate's Court had given final approval to a settlement which included the treatment of the 1965-1967 income distributions as being part of Mrs. Lemle's share of the corpus of the estate" [A-94]. Indeed, he was furnished with copies of the settlement documents, including the

August 12, 1970 agreement which, as Levitus states, "sets forth Mrs. Lemle's right to an elective share of corpus" [A-94].

Subsequent to the Surrogate's approval, and on June 15, 1971, Levitus filed his report allowing Mrs. Lemle's refund claim in full [A-105]. His report reads:

"Claims are allowed in full based upon ultimate determination of Surrogate's Court as to right of election as opposed to provisions of last will and testament of Julius Lemle" [A-105].

When this report was filed, Levitus was well aware that the Surrogate had already approved the Settlement Agreement. Accordingly, for all practical purposes, at that point Mrs. Lemle's refund claim had been allowed.

Marital Deduction of the \$453,000
Payment to Mrs. Lemle Allowed by the
I.R.S. - Refund of \$168,000 to the Estate

The parties to the settlement recognized that the payment of a fixed amount to Mrs. Lemle would entitle the estate to a refund of Federal estate taxes in the amount of \$168,778.96 [A-53]. The Government acquiesced in this understanding of the parties as appears from its 9(g) statement:

"11. The Internal Revenue Service has allowed a marital deduction to the Estate of Julius Lemle for the sum of \$453,712.25 pursuant to 26 U.S.C. §2056."

This ruling by the Government is a clear administrative finding that the payments made to Mrs. Lemle in 1965, 1966 and 1967 represented the value of an interest in property which "passes or has passed from the decedent to his surviving spouse", as Section 2056 clearly provides.

Culpable Neglect by the I.R.S.

What emerges from the record is the fact that the Government, having first allowed Mrs. Lemle's refund claim, suffered a change of heart when it appeared that the other income beneficiaries, who were clearly obligated under the Settlement Agreement and as a matter of law to pay the tax on the pre-settlement payments which had been made to Mrs. Lemle, reneged on their agreement.

Thus, Ballaine, in his affidavit, complained that

the "difficulty in this action" is that "the two other income beneficiaries do not presently intend to file amended returns for 1965, 1966 and 1967" [A-89]. The real problem, of course, is, as the affidavit suggests, that:

"It appears that the statute of limitations may bar the Internal Revenue Service from assessing these beneficiaries or the estate by reason of the additional income allocable to them for 1965-1967 under the agreements.")A-89)

Levitus, the revenue agent, was similarly "concerned" because "the limitations already appeared to have expired" [A-94].

But the expiration of the limitation period, if in fact it had expired, was clearly attributable to the neglect of the I.R.S. Levitus was fully cognizant of the provision in the settlement agreements under which the "income" payments made to Mrs. Lemle were to be deemed principal; and as a result, these sums did in fact become payable to the income beneficiaries for the years in question, subject to the appropriate income tax. As Levitus stated, since the settlement agreements deemed the 1965, 1966 and 1967 income distributions to Mrs. Lemle "as being of principal, not income", it became "necessary to charge those 1965-1967 income distributions to other parties to the settlement" [A-94].

There is no evidence in the record that the limitations statute in fact had expired since there is no proof of the date when the tax returns were actually filed. On the

contrary, there is evidence that Mrs. Lemle's tax return for 1965 had not been filed as late as August 1966, at which point an extension for the filing of the return had been obtained to September 1966 [A-29]. Levitus' affidavit is nebulous on this point. He is careful to state that "the limitation already appeared to have expired for tax years 1965 and 1966" [A-94]. There is absolutely no proof on this and Judge Conner was explicit that the expiration of the statute of limitations had not been "conclusively established" for any of these years [A-121, n. 7].

In any event, the I.R.S. was certainly on notice of this "difficulty" when the tax returns were filed [A-85]. It should have been clear to the I.R.S. that if Mrs. Lemle's claims, disclosed in her tax returns, were sustained, the tax was properly assessable against the other income beneficiaries who would become entitled to the income payments.

Certainly, there was nothing to prevent Levitus from requesting an extension of the statutory period from the other taxpayers and a jeopardy assessment was available if a voluntary waiver could not be obtained. Failure to take any action was sheer neglect and, as has already been indicated, was the motivating factor which resulted in the repudiation by the I.R.S. of its initial approval of her claimed refund.

The Decision of the District Court

As has been indicated in the foregoing, the District Court for reasons attributable, we submit, to the vacillating contentions of the Government, has written four opinions [A-111, A-122, A-135 and A-151]. It is relevant to review the first opinion, which we deem correct, and the fourth, from which this appeal is taken.

Judge Conner's First Opinion

The District Court's initial reliance was upon Section 102(a) and Lyeth v. Hoey, 305 U.S. 188 (1938) [A-116].

Section 102(a) expressly excludes from gross income "the value of property acquired by gift, bequest, devise or inheritance". Similar provisions have been contained in the Internal Revenue Code since 1913 (Lyeth v. Hoey, supra, at p. 195, n. 6). In Lyeth, which we submit is controlling here, Chief Justice Hughes stressed the comprehensive scope of this exclusion (pp. 194, 195):

"In exempting from the income tax the value of property acquired by 'bequest, devise, or inheritance,' Congress used comprehensive terms embracing all acquisitions in the devolution of a decedent's estate. For the word 'descent', as used in the earlier acts, Congress substituted the word 'inheritance' in the 1926 act and the

subsequent revenue acts as 'more appropriately including both real and personal property'. Thus the acquisition by succession to a decedent's estate whether real or personal was embraced in the exemption."

Further, the Chief Justice pointed out that since Congress had imposed an estate tax upon the transfer of the property of decedents, there was no suggestion that it intended to tax again the value of the same property when received by legatees, devisees or heirs. Thus, the Court said (p. 195):

"Further, by the 'estate tax', Congress has imposed a tax upon the transfer of the entire net estate of every person dying after September 8, 1916, allowing such exemptions as it sees fit in arriving at the net estate. Congress has not indicated any intention to tax again the value of the property which legatees, devisees or heirs receive from the decedent's estate."

The facts in Lyeth demonstrate its decisive applicability here. There, under the will offered for probate, the entire residuary estate, amounting to more than \$3,000,000, had been bequeathed to a foundation to preserve the "records of the earthly life of Mary Baker Eddy". The heirs objected, claiming lack of testamentary capacity and undue influence. While the proceeding was pending, a compromise

agreement was entered into under which the \$3,000,000 bequest was "disregarded"; \$200,000 payments were made to the heirs and to the Trust; and the net residue of the estate was divided equally between the Trust and the heirs.

Subsequently, the petitioner, one of the heirs, received his distributable share which the I.R.S. valued at \$141,484 and included in the taxpayer's income for the year in which it was received.

The Supreme Court ruled, as Judge Conner wrote [A-117], that "petitioner's status as an heir was not altered because his right to an inheritance was finally settled by compromise and that the exemption from income of gifts received by inheritance applied". The District Judge quoted from the Supreme Court's opinion the following language which is apt here [A-117]:

"Petitioner was concededly an heir of his grandmother under the Massachusetts statute. It was by virtue of the heirship that he opposed probate of her alleged will which constituted an obstacle to the enforcement of his right. * * *

"There is no question that petitioner obtained that portion, upon the value of which he is sought to be taxed, because of his standing as an heir and of his claim in that capacity. 305 U.S. at 195-86."

Thus, Judge Conner continued, "Lyeth v. Hoey established that money received by an heir pursuant to the settlement of a will contest is to be treated as if it were acquired by inheritance. Harte v. United States, 252 F. 2d 259, 261 (2d Cir. 1958)".

In expressly rejecting the Government's contention that, unlike in Lyeth, the Settlement Agreement had reclassified payments already made, Judge Conner stated [A-118]:

"This argument, however, ignores the import of the Supreme Court's decision in Lyeth v. Hoey, that proceeds obtained by compromise must be characterized, for purpose of federal income tax, according to the claims asserted and settled in the litigation. Erick v. C.I.R., 485 F. 2d 1049, 1054 (D.C. Cir. 1973); Howard v. C.I.R., 447 F. 2d 152, 155-56 (5th Cir. 1971); Larchfield Corp. v. United States, 243 F. Supp. 926, 943 (D. Conn. 1965), aff'd, 373 F. 2d 159 (2d Cir. 1966)."

The District Judge added that this rule was clearly applicable to the instant case, stating:

"Thus, plaintiff maintained throughout that she was entitled to one-third of the principal of the Estate, and the compromise agreement was intended to reflect a concession to this claim to principal. Moreover, plaintiff is concededly the wife of the testator and would, ordinarily, under the New York statute have been entitled to elect to take a one-third share of the estate against the Will. There can be no question that

she obtained the settlement for this reason. Cf. Lyeth v. Hoey, supra, at 195-96."

The District Judge also relied upon the decision of this Circuit in Harte v. United States, 252 F. 2d 259 (2d Cir. 1958), where the question was "whether payments received by the taxpayer under an agreement settling a will contest are taxable as income, or whether they are exempt as property acquired by inheritance".

It appeared that the decedent had left an estate valued in excess of \$3,000,000; though the appellant, Doris Harte, the decedent's granddaughter, was his only living descendant, the sole provision for her was the \$5,000 trust fund. After objections were filed, a settlement was entered into under which it was agreed that a trust will be established for the appellant consisting of stock in a real estate company and in addition, appellant was paid \$92,000 in cash representing dividends which had been paid on the stock while the litigation was pending. It was further provided that appellant would receive a monthly stipend for the remainder of her life. No issue was raised by the I.R.S. concerning the stock or payment of the intervening dividends-- the only question was whether the monthly stipend was taxable.

The Court, in its opinion, stated the rule established in Lyeth that money received by an heir in settlement of a will contest is to be treated as if it were acquired by inheritance. The narrow question was whether the prospective monthly payments to be made under the settlement agreement "were to be made from property or from income from property" (p. 261). The Court concluded that the dividends constituted "income from property"; and therefore were properly included in income.

Judge Conner's Fourth Opinion

Judge Conner finally adopted the Government's changed position which he summarized in his third opinion [A-139, A-140]:

"The Government's present position is founded upon the operation of Sections 102 and 662 of the Internal Revenue Code. According to the Government a review of those sections and the regulations thereunder belies what earlier had been assumed by both the parties and the Court--i.e., that plaintiff would have been entitled to exclude from her gross income all distributions from Mr. Lemle's estate if those distributions had been from corpus. Thus, defendant argues, principal distributions from an estate may be includible in gross income, within the meaning of Section 102(b) of the Internal Revenue Code, under circumstances described in Section 662(a)."

Section 662(a) Does Not Govern the
Lump Sum Settlement Payment to Mrs. Lemle

Section 662(a) must be read in the context of subchapter (J) of the Code, of which it is a part and which was introduced by the 1954 Revenue Code. The provisions of this subchapter have been the subject of numerous articles by tax lawyers and have been described by a veteran Surrogate as a "serious tax trap for the unwary", as well as "an important post mortem tax-planning tool in the hands of sophisticated fiduciary". In re Holloway's Estate, 68 Misc.2d 361, 327 N.Y.S.2d 865, 868 (1972). The issue before the Surrogate involved

"distributions [which] were deemed income under the 1954 Internal Revenue Code policy decision to treat all distributions, whether of corpus or income, as taxable income to the recipients to the extent of the estate's distributable net income. (Int. Rev. Code, §§ 661 and 662)" (p. 866)

But as Judge Conner pointed and as the pertinent Senate and House Reports made clear (infra, pp. 21, 22), the primary objective of these sections of the Code was basically simple -- it was to eliminate "the problem of tracing distributions to their source" [A-142], which had theretofore been required in order to distinguish between non-taxable principal and taxable income. But, as will be shown, it was not the purpose of these sections to transmute principal into

income and thereby abandon Section 102(a) and the similar legislative prohibitions of the tax on property acquired by gift, inheritance or devise in effect since 1913.

The legislative changes introduced by sub-chapter (J) were discussed at length in an article entitled "A Proposed Revision of the Federal Income Tax Treatment of Trusts and Estates--American Law Institute Draft" (53 Columbia L. Rev. 315 [1953]), where the authors pointed out that the conduit concept, under which estate and trusts are regarded as conduits through which income passes to the beneficiary, traditionally applied in the income taxation of estate distributions, had resulted in a burdensome "tracing requirement". To meet this problem, a draft statute had been prepared by the American Law Institute which substituted for the tracing requirement "the general rule that the beneficiary may be taxed upon a distribution whether or not its source is trust income of the current year, but that the taxable amount may not exceed the trust income of the year of distribution". The article continues (p. 331):

"The current trust income thus becomes a measure of taxability instead of a required source. The gift exemption is in effect revised to grant exemption to, and thus to treat as corpus distributions, only the amount received by a beneficiary which is in excess of the annual trust income."

Subchapter J Applies Only
to Income Beneficiaries

It hardly needs to be stated that the conduit concept, under which estates are deemed, in effect, pipeline stations from which income passes to the beneficiary, necessarily assumes that the beneficiaries are entitled to income.

The beneficiaries, as the beneficial owners of the estate, are entitled, in the shares provided for by will or intestacy, to their specified pro rata interests in the corpus of the estate and the income thereof. The only effect of subchapter J is to establish a presumption, to the extent of the estate's distributable net income, that the income beneficiaries have received their pro rata share of the income, whether or not the source of the distribution is corpus or income.

This appears in an analysis of the proposed legislative reforms, which ultimately became Sections 661, 662 and 663 of the 1954 Code, prepared by the drafters of the Restatement:

"Whether a distribution falls under . . . the definition of 'additional amounts distributed or required to be distributed' in subsection B is important only for purposes of determining which beneficiaries are deemed to receive the distributable net income in case the total distributions exceed the distributable net income"
(A.L.I., Tentative Draft No. 7, p. 426).

The House Report makes this clear (pp. 4086, 4087):*

"The bill adopts the general principle that to the extent of the trust's current income all distributions are deductible by the estate or trust and taxable to the beneficiaries. This approach represents a basic departure from the general rule of the existing law that taxable distributions must be traced to the income of the estate or trust for the current year.

"This approach, however, requires the use of a measure to impose an outside limit on the total distributions deductible by the estate or trust and taxable to the beneficiary. In general, the measure adopted by the bill for this purpose is taxable income, computed without regard to capital gains and losses unless these gains and losses are utilized in determining the income available for distribution.

"The bill adheres to the conduit theory of the existing law. This means that an estate or trust is in general treated as a conduit through which income passes to the beneficiary. . . ." (Emphasis supplied.)

It will be observed that there is no reference to any purpose to include principal distributions in taxable income, except to the extent of a presumption that all distributions, to the extent of the available income, shall be deemed income. The practical effect is that if a principal distribution is treated as income, the undistributed income remains as principal. No substantive change has been accomplished. The Senate report contains a similar description of the objectives of the Bill (pp. 4714-15):

* U.S. Code Cong. Adm. News, 83rd Cong.
2d Sess. 1954.

"(1) House changes accepted by committee

* * *

"The bill adopts the general principle that to the extent of the trust's current income all distributions are deductible by the estate or trust and taxable to the beneficiaries. This approach represents a basic departure from the general rule of the existing law that taxable distributions must be traced to the income of the estate or trust for the current year.

"This approach, however, requires the use of a measure to impose an outside limit on the total distributions deductible by the estate or trust and taxable to the beneficiary. In general, the measure adopted by the bill for this purpose is taxable income, computed without regard to capital gains and losses unless these gains and losses are utilized in determining the income available for distribution."

The Senate Report includes a detailed discussion of Section 662(a) which makes it explicit that income, not principal, is taxable (pp. 4989-90):

" . . . Instead of determining whether a particular distribution represents amounts of current or accumulated trust income, this revision, broadly speaking, provides that any distribution is considered a distribution of the trust or estate's current income to the extent of its taxable income for the year. This principle is similar to the determination of whether a dividend has been distributed, i.e., that every distribution made by a corporation is deemed to be out of earnings and profits to the extent thereof and from the most recently accumulated earnings and profits."

Judge Conner recognized that elimination of the tracing requirement was the essential objective of Section 662(a). In his opinion, he wrote [A-142]:

"The design of Section 662 is clear enough; the section as presently framed effectively eliminates the problem of tracing distributions to their source, a problem that had inevitably attended the former statutory schema. See 1954 U.S. Code Cong. & Admin. News at 4086-87, 4621, 4714-15, 4990 (83rd Cong., 2d Sess.)."

That this is the sole objective of the "distributable net income" concept has similarly been noted ("Distributions by Estates", Robert A. Parr, 107 Trusts & Estates 97 [1968]):

"The concept of DNI, introduced in the 1954 Internal Revenue Code, eliminates the necessity of tracing the source of a distribution, i.e., whether from income or principal, by treating any distribution made as income to the extent of the estate's DNI for the taxable year in which the distribution occurs."

The writer likewise observes that the DNI presumption is exactly that--it does not differ from the similar presumption applied in the corporate area:

"A similar presumption is found in the corporate area where there is a presumption that all distributions are made from current earnings and profits to the extent thereof. Section 316." (Parr, supra, p. 97).

This result, achieved with extraordinary complexity by the intricate language of subchapter J, is simplicity itself. If, for example, an estate has a net taxable income (or DNI) of \$10,000, its distributions to income distributees are taxable up to \$10,000 whether or not the property distributed consists of corpus or income. As has been indicated, if corpus is distributed, the estate retains the undistributed DNI as a substitute for the paid out corpus--the tax consequences both to the estate and to the distributees are the same.

Section 663 Expressly Excludes from
Income the Settlement Payments to
Mrs. Lemle

Section 663 spells out, practically in haec verbis, that the DNI concept, designed to eliminate difficult tracing problems, was not remotely aimed at abolishing the traditional exclusion from taxable income of property acquired by "gift, devise or inheritance".

Section 663, captioned "Special Rule Applicable to Sections 661 and 662", provides in pertinent part:

"(a) Exclusions.--There shall not be included as amounts falling within section 661(a) or 662(a)--

"(1) Gifts, bequests, etc.--Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money."

This section covers precisely the specific sum of \$453,712.25 which Mrs. Lemle acquired by "inheritance" when she received this sum in payment of her right to elect against the Will of her husband and to take her intestate share of the corpus.

The Authorities Support Mrs. Lemle's Claim

A striking example of a fact situation in which a lump-sum payment out of an estate was found to be exempt from the Section 662(a) rules even though the estate in question had substantial distributable net income is found in Revenue Ruling 57-214 (Cum. Bull. 1957-1). There, decedent's will created a trust of X dollars from the residue of his estate for the benefit of his son. The distributable net income of the estate exceeded the amount needed to fund the trust.

The I.R.S. ruled that this lump sum distribution was non-taxable under Section 663(a):

"In the instant case, . . . it is concluded that funding of the trust would constitute a payment, under the terms of the will, of a bequest of a specific sum of money within the meaning of section 663(a)(1) of the Code and as such is neither taxable to the trustee nor deductible by the executor."

Similarly applicable here is another Revenue Ruling (Cum. Bull. 1964-1 [Part 1], 77. The ruling is headnoted by the I.R.S. as follows:

"The value of a dower interest received free from liability for all debts of the decedent and all costs, charges, and expenses of administration of the estate, pursuant to the laws of Florida, is not includible in the widow's gross income under sections 661 and 662 of the Internal Revenue Code of 1954, but, instead, is subject to the general provisions of section 102 of the Code."

It was pointed out in support of this ruling that under Florida law, a widow's dower rights granted her "a fee simple estate in lands and the absolute ownership of the personal property allotted free from all debts of the decedent and all costs, charges and expenses of administration". As a result, it was ruled that the dower interest is even more absolute than real property, title to which passes directly from the decedent to the devisees, since real property might

be liable for the debts of the estate. The ruling concludes as follows:

"Accordingly it is held that the value of the assets transferred to the widow as dower is not includible in her gross income under Sections 661 and 662 of the Code. Such transfer is governed only by the general provisions of Section 102 of the Code."

Of course, to the extent that the widow received "2 X dollars of ~~mesne~~ profits earned by the dower assets", these profits were "includible in her gross income" (p. 79).

The appropriate application of the presumption established under Section 662 was elaborated in Harkness v. United States, 469 F. 2d 310 (Ct. Claims, 1973), where the plaintiff's husband, by his will, bequeathed plaintiff one-half of his residuary estate and the remaining half in equal shares to the trustees of four trusts for his children, subject to the proviso that estate taxes were to be paid out of the provisions for the children. The executors, in 1955, made total distributions of \$36 million dollars, of which plaintiff received \$27.4 million and the four trusts received the balance of \$8.4 million, the disproportion being attributable to the fact that the widow's share was free of estate taxes. The \$27.4 million paid to the plaintiff equalled 76.2% of the \$36 million dollars distributable to all beneficiaries in the taxable year.

The fiduciary income tax return filed by the executors showed distributable net income in 1955 of \$1,005,682; and a deduction of \$826,758 was taken for distributions to the five residuary estate beneficiaries, the difference of \$178,924 consisting of tax-exempt income and expenses allocable thereto.

Applying Section 662, the District Director assessed against the plaintiff a tax of 76.2% of the distributable net income figure of \$826,758, resulting in taxable income of \$630,740. The plaintiff contended that the executors of the estate, in calculating the amount of corpus and the income distributed, charged the plaintiff with one-half of the distributable net income, that is, \$413,379.

The obvious basis for this accounting calculation by the executors was that plaintiff, as a beneficiary of one-half of the estate, for accounting purposes, was held chargeable with one-half of the income--though, since the estate taxes were chargeable to the other four beneficiaries, she in fact received 76.2% of the total sums distributed. As the Court pointed out, the statutory formula under Section 662 resulted in a "natural and logical result--income earned during the administration of the residuary estate is allocated

to the beneficiaries in the same ratio as their interest in the corpus of such estate" (p. 317). The Court then added (p. 317):

"Generally, of course, various percentages of corpus will produce like percentages of income. It is thus plain that plain' fr's situation is, by the unambiguous provisions thereof, covered by the statute and although recognizing, of course, the difficulties involved in envisaging every specific situation that could arise under general statutory language, it would nevertheless appear to constitute the type of situation that Congress intended should be covered."

s, the plaintiff, having received in dollars 76.2% of the principal and income distributed, was chargeable with income tax on 76.2% of the taxable income--nothing could be fairer or more logical. Here, the plaintiff received a specific bequest of \$453,712.25 -- she was not paid any of the income earned by that sum and is, therefore, not chargeable with income tax on income she did not receive and was not entitled to.

The Error of the District Court
in Relying upon Reg. 1.663(a)-1(b)

The nub of the District Court's decision, and, we submit the error in its reasoning, appears in the following excerpt from the Court's opinion [A-155]:

"We need not pause to describe the pains taken by plaintiff in her understandably awkward effort to fit the payments received by her pursuant to the 1971 settlement within the bounds of Section 663(a). In this respect, we linger only long enough to note in wonderment that plaintiff herself supplies the proper -- and, for her cause, damning -- measure of this last argument by recalling our attention to Federal Income Tax Regulation 1.663(a)-1, which, in relevant part, explains:

"'In order to qualify as a gift or bequest of a specific sum of money or of specific property under section 663(a), the amount of money or of specific property must be ascertainable under the terms of a testator's will as of the date of his death * * * .'
26 C.F.R. § 1.663(a)-1(b)(1)."

Upon the basis of this Regulation, consisting of less than a paragraph excerpted from 4 pages of closely printed regulations under Section 663(a), the Court dismissed the complaint on the ground that the settlement was "effected years subsequent to the death of plaintiff's husband" [A-155]. We submit that this is clear error. The regulations make clear that the ascertainability of the

of the amount distributed depends, not on whether the computation can be made as of the date of death, but upon the existence on the date of death of the facts upon the basis of which the distribution was made.

The regulations expressly describe as includable within Section 663(a) "bequests to a decedent's son of the decedent's interest in a partnership and to his daughter of a sum of money equal to the value of the partnership interest" (1.663[a]-1.[b]). Clearly, there is no way in which the value of a partner's interest can be computed on the day of his death. Obviously, the dollar amount would necessarily be determined after the payment of partnership debts and expenses and a myriad of other offsets and credits, which could take years to resolve (assuming no litigation, as often occurs on the death of a partner).

Nevertheless, these bequests are deemed to be "of specific property and of a specific sum of money, respectively" (Reg. 1.663[a]-1.[b]). On the other hand, the Regulations continue, a bequest to a decedent's spouse of a sum equal in value to a fraction of the decedent's "adjusted gross estate 'is neither a bequest of a specific sum of money or of specific property'". The reason is that the "amount of money specified" is dependent upon the results of the conduct of the estate's affairs as an income-producing entity, since the spouse who

has been bequeathed a fraction of the decedent's gross estate is the beneficiary of the property and the income thereof. As a result, the amount of the bequest or devise is dependent on various circumstances, none of which are "facts existing on the date of the decedent's death" (Id.).

Thus, where the amount of the bequest of principal or corpus depends upon the operating results of the estate, the bequest is not excludable under Section 663(a); contrariwise, where the value of the bequest (as in the case of a partnership interest) is independent of the estate's operating results, the bequest is non-taxable.

In the instant case, the fact that the settlement was effected years subsequent to the decedent's death is irrelevant. The lapse of time did not add or detract from the specific sum finally agreed to be paid to the plaintiff. If on the date the decedent died and the will was read, the negotiations began and, by some miracle, were consummated, the sum agreed upon would clearly be covered by Section 663 and would certainly not be taxable, in whole or in part, to the plaintiff. Protracted negotiations and legal proceedings which deferred agreement upon the specific sum to be paid has no legal significance under Section 663 which, as has been indicated, excludes from income any specific sum of money paid or credited all at once under the terms of the governing instrument, to wit, the Settlement Agreement.

The Regulations are, of course, designed to implement the Code, not to modify its provisions by changes in substance. Section 663(a) excludes from the income defined in Section 662(a): "Any amount which under the terms of the governing instrument is properly paid or credited as a gift or bequest of a specific sum of money or of specific property" There is no reference to the phrase, included in the Regulations, that the amount of the property must be ascertainable as of the date of death of the testator. This language was obviously not intended to apply to settlements of will contests, which would necessarily post-date the death of the testator; and in any event, the obvious purpose of this qualifying clause was to limit the exclusion solely to distributees of principal--only those entitled to income and principal would receive sums not ascertainable as of the testator's death.

But in the instant case, where the distributee, by settlement, received a specific sum (and no income thereon), the intent of the Regulations is squarely applicable. Mrs. Lemle is in precisely the same position, income-wise, as if she received a specific legacy of \$453,712.25, which would of course have been ascertainable as of the date of the death of the decedent.

Effect of the 16th Amendment

In analyzing the interaction of Sections 102(a) and subchapter J (Sections 661-663), it is well to remember that the exclusion of the corpus of property acquired by gift, devise or inheritance from taxable income is not a Congressional dispensation. It is mandated by the 16th Amendment to the Constitution which restricts the power of Congress to impose direct taxes, without apportionment, on "income from whatever source derived".

The word "income" is defined "as the word is known in the common speech of men" (United States v. Safety Car Holding Co., 297 U.S. 88, 99 [1936]), and is limited to "gain derived from capital, from capital, from labor, or from both combined, including profit gained through sale or conversion of capital" (Bowers v. Kerbaugh-Empire Co., 271 U.S. 170, 174 [1926]). It is on this theory that stock dividends were held exempt under the Constitution from income taxation since a stock dividend is a distribution of capital, not income (Eisner v. Macomber, 252 U.S. 189 [1920]).

Conclusion

In the final analysis, the plaintiff is entitled to judgment because having received principal, she is not subject to income tax. The definition of the income tax by a learned English jurist almost four decades ago is apt:

"Income tax, if I may be pardoned for saying so, is a tax on income" (London Co. Counsel v. Attorney General [1901] A.C. 26, 35, Lord MacNaughton).

Respectfully submitted,

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A P P E N D I X

§ 102. Gifts and inheritances

(a) **General rule.**—Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

(b) **Income.**—Subsection (a) shall not exclude from gross income—

- (1) the income from any property referred to in subsection (a); or
- (2) where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.

Where, under the terms of the gift, bequest, devise, or inheritance, the payment, crediting, or distribution thereof is to be made at intervals, then, to the extent that it is paid or credited or to be distributed out of income from property, it shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property. Any amount included in the gross income of a beneficiary under subchapter J shall be treated for purposes of paragraph (2) as a gift, bequest, devise, or inheritance of income from property.

Aug. 16, 1954, c. 736, 68A Stat. 28.

§ 661. Deduction for estates and trusts accumulating income or distributing corpus

(a) **Deduction.**—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

(b) **Character of amounts distributed.**—The amount determined under subsection (a) shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the estate or trust as the total of each class bears to the total distributable net income of the estate or trust in the absence of the allocation of different classes of income under the specific terms of the governing instrument. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642(c)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary or his delegate.

(c) **Limitation on deduction.**—No deduction shall be allowed under subsection (a) in respect of any portion of the amount allowed as a deduction under that subsection (without regard to this subsection) which is treated under subsection (b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust. Aug. 16, 1954, c. 736, 68A Stat. 220.

§ 662. Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus

(a) **Inclusion.**—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661(a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) **Amounts required to be distributed currently.**—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 642(c), relating to deduction for charitable, etc., purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase "the amount of income for the taxable year required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

(2) **Other amounts distributed.**—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

(b) **Character of amounts.**—The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642(c)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary or his delegate. In the application of this subsection to the amount determined under paragraph (1) of subsection (a), distributable net income shall be computed without regard to any portion of the deduction under section 642(c) which is not attributable to income of the taxable year.

(c) **Different taxable years.**—If the taxable year of a beneficiary is different from that of the estate or trust, the amount to be included in the gross income of the beneficiary shall be based on the distributable net income of the estate or trust and the amounts properly paid, credited, or required to be distributed to the beneficiary during any taxable year or years of the estate or trust ending within or with his taxable year. Aug. 16, 1954, c. 736, 68A Stat. 220.

§ 663. Special rules applicable to sections 661 and 662

(a) **Exclusions.**—There shall not be included as amounts falling within section 661(a) or 662(a)—

(1) **Gifts, bequests, etc.**—Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

(2) **Charitable, etc., distributions.**—Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642(c) (computed without regard to sections 508(d), 681, and 4948(c) (4)).

(3) **Denial of double deduction.**—Any amount paid, credited, or distributed in the taxable year, if section 651 or section 661 applied to such amount for a preceding taxable year of an estate or trust because credited or required to be distributed in such preceding taxable year.

(b) **Distributions in first sixty-five days of taxable year.**—

(1) **General rule.**—If within the first 65 days of any taxable year of a trust, an amount is properly paid or credited, such amount shall be

(2) **Limitation.**—Paragraph (1) shall apply with respect to any taxable year of a trust only if the fiduciary of such trust elects, in such manner and at such time as the Secretary or his delegate prescribes by regulations, to have paragraph (1) apply for such taxable year.

(c) **Separate shares treated as separate trusts.**—For the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary or his delegate. Aug. 16, 1954, c. 736, 68A Stat. 222; Dec. 30, 1969, Pub.L. 91-172, Title I, § 101(j) (17), Title III, § 331(b), 83 Stat. 528, 598.

§ 2056. Bequests, etc., to surviving spouse

(a) **Allowance of marital deduction.**—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

§ 1.663(a)-1 Special rules applicable to sections 661 and 662; exclusions; gifts, bequests, etc.

(a) In general. A gift or bequest of a specific sum of money or of specific property, which is required by the specific terms of the will or trust instrument and is properly paid or credited to a beneficiary, is not allowed as a deduction to an estate or trust under section 661 and is not included in the gross income of a beneficiary under section 662, unless under the terms of the will or trust instrument the gift or bequest is to be paid or credited to the recipient in more than three installments. Thus, in order for a gift or bequest to be excludable from the gross income of the recipient, (1) it must qualify as a gift or bequest of a specific sum of money or of specific property (see paragraph (b) of this section), and (2) the terms of the governing instrument must not provide for its payment in more than three installments (see paragraph (c) of this section). The date when the estate came into existence or the date when the trust was created is immaterial.

(b) Definition of a gift or bequest of a specific sum of money or of specific property. (1) In order to qualify as a gift or bequest of a specific sum of money or of specific property under section 663(a), the amount of money or the identity of the specific property must be ascertainable under the terms of a testator's will as of the date of his death, or under the terms of an inter vivos trust instrument as of the date of the inception of the trust. For example, bequests to a decedent's son of the decedent's interest in a partnership and to his daughter of a sum of money equal to the value of the part-

nership interest are bequests of specific property and of a specific sum of money, respectively. On the other hand, a bequest to the decedent's spouse of money or property, to be selected by the decedent's executor, equal in value to a fraction of the decedent's "adjusted gross estate" is neither a bequest of a specific sum of money or of specific property. The identity of the property and the amount of money specified in the preceding sentence are dependent both on the exercise of the executor's discretion and on the payment of administration expenses and other charges, neither of which are facts existing on the date of the decedent's death. It is immaterial that the value of the bequest is determinable after the decedent's death before the bequest is satisfied (so that gain or loss may be realized by the estate in the transfer of property in satisfaction of it).

(2) The following amounts are not considered as gifts or bequests of a sum of money or of specific property within the meaning of this paragraph:

(i) An amount which can be paid or credited only from the income of an estate or trust, whether from the income for the year of payment or crediting, or from the income accumulated from a prior year;

(ii) An annuity, or periodic gifts of specific property in lieu of or having the effect of an annuity;

(iii) A residuary estate or the corpus of a trust; or

(iv) A gift or bequest paid in a lump sum or in not more than three installments, if the gift or bequest is required to be paid in more than three installments under the terms of the governing instrument.

(3) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples, in which it is assumed that the gift or bequest is not required to be made in more than three installments (see paragraph (c)):

Example (1). Under the terms of a will, a legacy of \$5,000 was left to A, 1,000 shares of X company stock was left to W, and the balance of the estate was to be divided equally between W and X. No provision was made in the will for the disposition of income of the estate during the period of administration. The estate had income of \$25,000 during the taxable year 1954, which was accumulated and added to corpus for estate accounting purposes. During the

taxable year, the executor paid the legacy of \$5,000 in a lump sum to A and transferred the X company stock to W. No other distributions to beneficiaries were made during the taxable year. The distributions to A and W qualify as exclusions within the meaning of section 663(a) (1).

Example (2). Under the terms of a will, the testator's estate was to be divided equally between A and B. No provision was made in the will for the disposition of income of the estate during the period of administration. The estate had income of \$50,000 for the taxable year 1954. In accordance with an agreement among the beneficiaries that part of the assets of the estate would be distributed in kind to the beneficiaries, stock in corporation X was distributed to A during 1954. The fair market value of the stock was \$40,000 on the date of distribution. No other distribution was made during the year. The distribution does not qualify as an exclusion within the meaning of section 663(a) (1), since it is not a specific gift to A required by the terms of the will. Accordingly, the fair market value of the property (\$40,000) represents a distribution within the meaning of section 661(a) and section 662(a) (see paragraph (c) of § 1.661(a)-2).

Example (3). Under the terms of a trust instrument, income is to be accumulated during the minority of A. Upon A's reaching the age of 21, \$10,000 is to be distributed to B out of income or corpus. Also at that time, \$10,000 is to be distributed to C out of the accumulated income and the remainder of the accumulations are to be paid to A. A is then to receive all the income until he is 25, when the trust is to terminate. Only the distribution to B would qualify for exclusion under section 663(a) (1).

(4) A gift or bequest of a specific sum of money or of specific property is not disqualified under this paragraph solely because its payment is subject to a condition. For example, provision for a payment by a trust to beneficiary A of \$10,000 when he reaches age 25, and \$10,000 when he reaches age 30, with payment over to B of any amount not paid to A because of his death, is a gift to A of a specific sum of money payable in two installments, within the meaning of this paragraph, even though the exact amount payable to A cannot be ascertained with certainty under the terms of the trust instrument.

(c) Installment payments. (1) In determining whether a gift or bequest of a specific sum of money or of specific property, as defined in paragraph (b) of this section, is required to be paid or credited to a particular beneficiary in more than three installments—

(i) Gifts or bequests of articles for personal use (such as personal and household effects, automobiles, and the like) are disregarded.

(ii) Specifically devised real property, the title to which passes directly from the decedent to the devisee under local law, is not taken into account, since it would not constitute an amount paid, credited, or required to be distributed under section 661 (see paragraph (e) of § 1.661(a)-2).

(iii) All gifts and bequests under a decedent's will (which are not disregarded pursuant to subdivisions (i) and (ii) of this subparagraph) for which no time of payment or crediting is specified, and which are to be paid or credited in the ordinary course of administration of the decedent's estate, are considered as required to be paid or credited in a single installment.

(iv) All gifts and bequests (which are not disregarded pursuant to subdivisions (i) and (ii) of this subparagraph) payable at any one specified time under the terms of the governing instrument are taken into account as a single installment.

For purposes of determining the number of installments paid or credited to a particular beneficiary, a decedent's estate and a testamentary trust shall each be treated as a separate entity.

(2) The application of the rules stated in subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). (i) Under the terms of a decedent's will, \$10,000 in cash, household furniture, a watch, an automobile, 100 shares of X company stock, 1,000 bushels of grain, 500 head of cattle, and a farm (title to which passed directly to A under local law) are bequeathed or devised outright to A. The will also provides for the creation of a trust for the benefit of A, under the terms of which there are required to be distributed to A, \$10,000 in cash and 100 shares of Y company stock when he reaches 25 years of age, \$25,000 in cash and 200 shares of Y company stock when he reaches 30 years of age, and \$50,000 in cash and 300 shares of Y company stock when he reaches 35 years of age.

(ii) The furniture, watch, automobile, and the farm are excluded in determining whether any gift or bequest is required to be paid or credited to A in more than three installments. These items qualify for the exclusion under section 663(a) (1) regardless of the treatment of the other items of property bequeathed to A.

(iii) The \$10,000 in cash, the shares of X Company stock, the grain, the cattle and the assets required to create the trust, to be paid or credited by the estate to A and the trust are considered as required to be paid or credited in a single installment to each, regardless of the manner of payment or distribution by the executor, since no time of payment or crediting is specified in the will. The \$10,000 in cash and shares of Y Company stock required to be distributed by the trust to A when he is 25 years

old are considered as required to be paid or distributed as one installment under the trust. Likewise, the distributions to be made by the trust to A when he is 30 and 35 years old are each considered as one installment under the trust. Since the total number of installments to be made by the estate does not exceed three, all of the items of money and property distributed by the estate qualify for the exclusion under section 663(a) (1). Similarly, the three distributions by the trust qualify.

Example (2). Assume the same facts as in example (1), except that another distribution of a specified sum of money is required to be made by the trust to A when he becomes 40 years old. This distribution would also qualify as an installment, thus making four installments in all under the trust. None of the gifts to A under the trust would qualify for the exclusion under section 663(a) (1). The situation as to the estate, however, would not be changed.

Example (3). A trust instrument provides that A and B are each to receive \$75,000 in installments of \$25,000, to be paid in alternate years. The trustee distributes \$25,000 to A in 1954, 1956, and 1958, and to B in 1955, 1957, and 1959. The gifts to A and B qualify for exclusion under section 663(a) (1), although a total of six payments is made. The gifts of \$75,000 to each beneficiary are to be separately treated.

STATE OF NEW YORK)
COUNTY OF NEW YORK) ss .

DAVIDO A. HENRY, being duly sworn,
deposes and says that deponent is not a party to the action,
is over 18 years of age and resides at 661 GREENE AVE
BROOKLYN - N. Y.

That on the 1 day of NOVEMBER, 1977,
deponent personally served the within BRIEF OF BERTHA LEMLE
AS PLAINTIFF APPELLANT
upon the attorneys designated below who represent the
indicated parties in this action and at the addresses below
stated which are those that have been designated by said
attorneys for that purpose

By leaving 2 true copies of same with a duly
authorized person at their designated office.

~~By depositing true copies of same enclosed
in a postpaid properly addressed wrapper, in the post office
or official depository under the exclusive care and custody
of the United States post office department within the State
of New York.~~

Names of attorneys served, together with the names
of the clients represented and the attorneys' designated
addresses

PAUL J. CURRAN
United States Attorney for the Southern
District of New York
Attorney for Defendant-Appellee
United States Courthouse
Foley Square
New York, New York 10007
(212) 264-6397

Sworn to before me this

1st day of November, 1977

David A. Henry

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Queens County
Commission Expires March 30, 1979

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Queens County